Internal Revenue Service

memorandum

CC:TL-N-6527-88
SWIanacone

date: AUG 24 1988

to: [redacted], Special Trial Attorney
Regional Counsel's Office, [redacted]

from: Director, Tax Litigation Division

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subject: Retroactive Application of Arkansas Best to Pending Examinations

This is in response to your request for formal technical advice concerning the retroactive application of Arkansas Best Corporation v. Commissioner, 485 U.S. ___, 108 S.Ct. 971 (1988), to pending examinations.

ISSUE

Whether the Supreme Court's decision in Arkansas Best should be applied retroactively to the pending examination of [redacted]'s [redacted] through [redacted] taxable years to deny the ordinary loss characterization which [redacted] reported on the disposition of stock which [redacted] held in its [redacted]

CONCLUSION

While it is our position that the holding in Arkansas Best should normally be applied retroactively to all open years of a taxpayer, in this particular case, since [redacted] received a Private Letter Ruling (PLR) authorizing the characterization of the gains and losses on the disposition of the stock it held in its [redacted] as ordinary, we believe that [redacted] can rely on the authority of the PLR up to the date of Notice 87-68, 1987-41 I.R.B. 34, which suspended revenue rulings that relied upon or applied the Corn Products doctrine.

DISCUSSION

Private Ruling 7010091000A was issued to [redacted] on [redacted]. In it, the Service examined the process by which [redacted] was attempting to develop a strong network of dealerships owned and operated by independent businessmen.

According to the PLR, in order to develop this network, [redacted] initiated the [redacted], which was essentially a marketing operation. In [redacted]

transferred the stock of both its wholly-owned and partially-owned [redacted] corporations to [redacted], its marketing subsidiary.

[redacted], through the [redacted], provided all or most of the initial capital of each of the dealerships. In return, [redacted] received voting preferred stock which the dealer agreed to redeem for the par value indicated on the stock. Since many of the [redacted] corporations suffered start-up losses which resulted in impairment of their capital, additional funds were provided by [redacted] to offset these deficits.

These additional payments were treated as contributions to the capital of the [redacted] corporations, thus increasing [redacted] basis in the stock. Since [redacted] was required to have its stock in the [redacted] corporations redeemed at par, net losses were incurred in each year on the sale and/or redemption of the stock of [redacted] corporations.

In discussing the characterization of [redacted] losses, the PLR stated that "the whole [redacted] is nothing but a marketing technique coupled with a method of financing the marketing of [redacted] products through the medium of such technique," and that "the unique nature of this financing of a marketing technique cannot be disregarded." Based on the rationale of Katz v. Commissioner, T.C. Memo. 1960-200 and Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955), the PLR determined that the preferred stock interest which [redacted] held in the [redacted] corporations were not capital assets and that each sale or redemption of the stock was to be treated as the sale or exchange of a non-capital asset so that gain or loss recognized thereon will constitute ordinary income or ordinary loss.

The position taken in the PLR was reinforced in the File Memorandum written as a result of the October 13, 1978 memorandum to the District Director in [redacted] granting [redacted] permission to change its accounting treatment of capital contributions to the [redacted] corporations. The File Memorandum concurred with the PLR determination that the [redacted] was a marketing technique and stated, "that any gains or losses incurred in the operation of the plan constitute gains or losses from marketing operations rather than the sale of securities or 'dealerships.'"

Had [redacted] relied only on our published rulings in this area, we would not hesitate to challenge the characterization of its losses on the redemption of the stock as ordinary. However, because of the unique nature of a PLR, it is the position of this office that [redacted] can rely on the PLR up to the date of our announcement that we were suspending revenue rulings that rely upon or apply the Corn Products doctrine. See Notice 87-68, 1987-41 I.R.B. 34. Therefore, we believe that the proposed adjustments attributable to this issue would be unwarranted.

If we can be of further assistance, please contact Steven W. Ianacone at FTS 566-3407.

MARLENE GROSS

By: _____
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